Markets with Advice: A Framework for Consumer Protection

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Policy Debate on Consumer Protection

US Treasury proposal of Consumer Financial Protection Agency (CFPA):

"To address this problem, we propose granting the CFPA authority to **impose** carefully crafted **duties of care on financial intermediaries**. For example, the CFPA could impose a duty of care to counteract an intermediary's patent conflict of interest, or to align an intermediary's conduct with consumers' reasonable expectations as demonstrated by empirical evidence.

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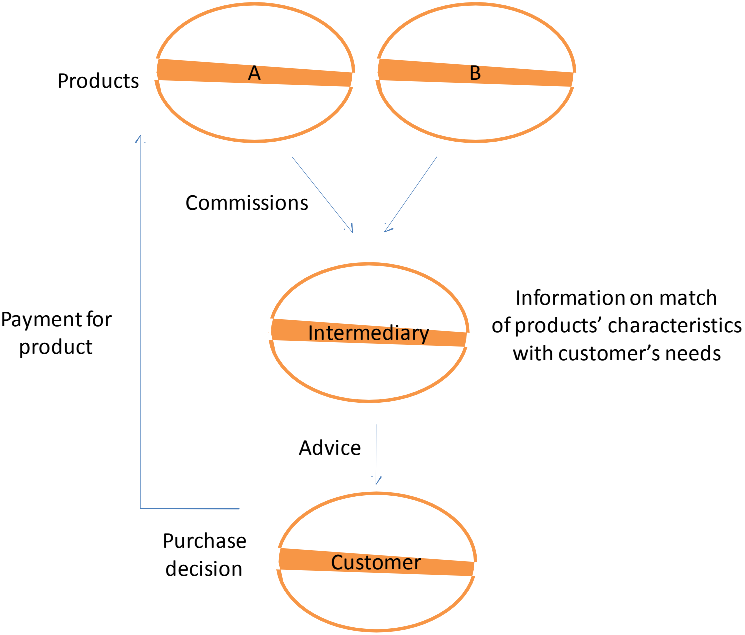
UK Financial Services Authority proposal of complete **switch to direct pay for advice***:*
". . . require advisor firms to be paid by advisor charges"
". . . **not allow** adviser firms to receive **commissions** offered **by product providers**"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Commissions
Payment for
product
Intermediary
Information on match
of products' characteristics
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Advice
Purchase
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  - **consumer protection** policy is effective
  - competition policy can be counterproduction, because it worsens the quality of advice

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- Persistent claims of **unsuitable advice**
  - US mutual funds with higher fees have higher commissions & underperform; Bergstresser & al (2007), Edelen & al (2008), Chen & al (2007)

Evidence from ARMs (Adjustable-Rate Mortgages)

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- **In 2004-2007** borrowers with lower comprehension and less suspicion are more likely to purchase ARM
- ARMs exhibited higher rates of foreclosure than fixed rate mortgages (FRMs) **during the mortgage crisis**

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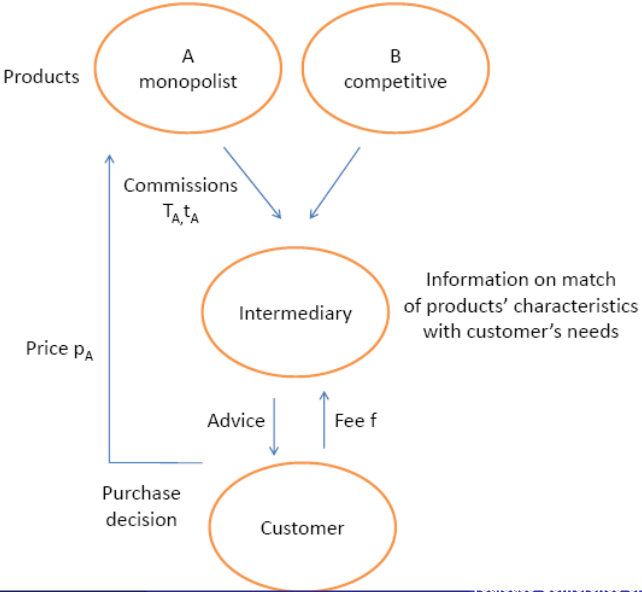
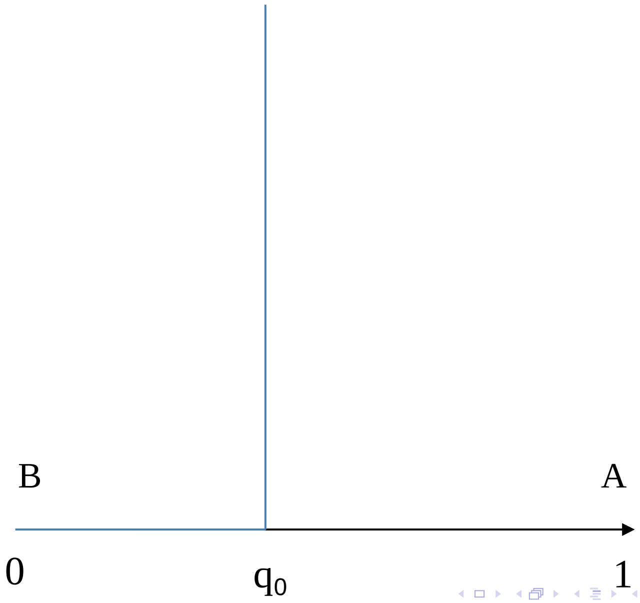


2] Demand & Information: Mapping to Hotelling

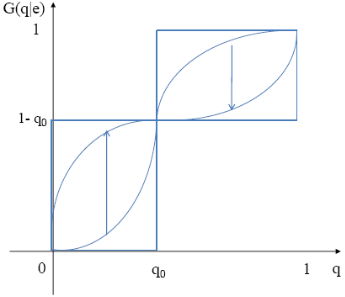


2] Modeling Information

Higher information acquisition effort results in a mean-preserving rotation of posterior distribution

$$\frac{dG(q \mid e)}{de} > 0 \text{ for } q < q_0, \; \frac{dG(q \mid e)}{de} < 0 \text{ for } q > q_0,$$

corresponding to a Blackwell more informative experiment



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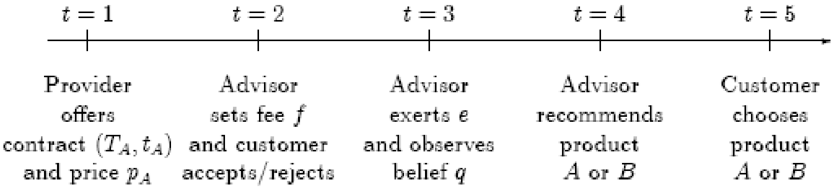

Figure 1: Timeline.

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